

STATE OF WASHINGTON

THIRD REPORT

OF

Washington State Liquor Control
Board



October 1, 1935

TO

September 30, 1936

OLYMPIA
STATE PRINTING PLANT
1936

**DEFENDANT'S
EXHIBIT**

CASE
NO. C04-0360P

EXHIBIT
NO. 416

TX416-001

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LETTER OF TRANSMITTAL

December 10, 1936.

To His Excellency, Clarence D. Martin, Governor
State of Washington, Olympia.

Sir: The Washington State Liquor Control Board submits herewith its
report of operations for the period October 1, 1935, to September 30, 1936,
as required by the Washington State Liquor Act.

Respectfully,

L. E. GREGORY, Chairman,
W. J. LINDBERG, Member,
HENRY GREGERSON, Member.

WASHINGTON STATE LIQUOR CONTROL BOARD

Report of Operations

OCTOBER 1, 1935, TO SEPTEMBER 30, 1936

The Board submits herewith a report of its operations for the 12 months ending September 30, 1936, as required by section 72 of the Washington State Liquor Act. This, the third report of the Board, is the first one to cover a full year's operation. The figures presented in this report, therefore, give a much more comprehensive and accurate picture of the Board's operations than do the statements contained in either of the two prior reports, each of which covered less than a full year's operations.

SUMMARY OF PROGRESS

Organization

When the Liquor Control Board was appointed by Governor Martin on January 29, 1934, he charged that its operations be conducted in a business-like manner irrespective of political consideration. A personnel of over 500 has been built up by the Board entirely on the merit of each person without political bias. The Board commenced its operations with no money and no personnel. No trained men were available and every individual that was hired had to be trained to fill his particular job. The powers granted the Board under the law were extremely broad and to carry out the requirements of the Act a great number of regulations had to be developed and enforced. Conditions in Washington after the repeal of prohibition were "wide open." The state store monopoly system was a new experiment. The control of all licensing under a centralized state body was untried. The Board had to meet these and many other problems in a very short space of time.

Operating Funds

The Board was organized with no capital whatsoever, the right to sell bonds was granted but they could not be sold without paying rates of interest and costs of marketing that were prohibitive. The Board started its operations on credit, using a hand-to-mouth buying policy, and buying on a 90-day credit basis. Profits were put back into the business and within a few months the Board was discounting all bills. By always paying cash, over one quarter of a million dollars has already been saved for the people of the State. During the first winter the Board had to borrow from banks to carry it through the peak holiday business. These loans were made first at 4% and later at 1½%. However, after the first winter no further loans were required.

Profits

On September 30, 1936, the Board had invested in its business over \$1,750,000 and it had made a total distribution of profits of \$5,000,000 which had been paid into the general funds of the State, counties and cities. The Board had also paid \$200,000 into the state building fund and had collected over \$1,650,000 under the special 10% sales tax. In other words, in 2½ years, starting with nothing, the Board had made over \$8,600,000 for the people of the State.

Losses and Cost of Operation

During the special session of the legislature which was called to enact the liquor control law in December, 1933, grave doubts were expressed as to the feasibility of state monopoly operation and it was freely predicted that shortages would be large and overhead abnormally high. Actual facts show that contrary to these predictions the total of cash losses, inventory losses, and breakage only amount to one-twentieth of one per cent, while the total overhead costs amount to less than six per cent of the gross sales.

Distribution of Outlets

On September 30, 1936, there were 48 stores and 127 state controlled agencies conveniently serving every person in the State. There were also 5,806 beer and wine retail establishments operating under the licensing requirements and regulations of the Board. The regulation of these licensed establishments has improved during the period of the Board's existence and as the Board and its personnel gains experience in this specialized work, further improvement will be made.

Hearings of Licensees

Although the Board has the right to suspend, cancel, or deny licenses without a hearing, in fairness to all concerned it has always granted hearings except in a few extreme cases. To date over 400 such hearings have been held in all parts of the State with the result that the cooperation and respect of licensees, local authorities, and the general public has been gained.

Home Industry

The Board had also granted licenses to 267 beer wholesalers and to 50 manufacturers in the state. That home industry has been encouraged is shown by the fact that two and one-half times as much beer is exported by Washington breweries for sale outside the state as is imported for sale in the state from breweries in other states. Furthermore, one-fourth of the wine now sold in the state is produced by local wineries using Washington farm products exclusively. This wine industry, which is entirely new in Washington, is growing rapidly and as soon as production can be increased it will probably take over an even larger proportion of the business.

Purpose of the Board

One of the duties of the Board was to put the bootlegger out of business and this has been done by selling liquor at prices as low or lower than any in the country. The Board has kept before it consistently the need for an honest and efficient administration. It has at all times insisted upon a proper code of ethics by brewers, wholesalers and retail licensees. It has endeavored to protect residential sections from the incursion of disagreeable and disreputable conditions. It is ever insisting that licensees shall not sell to minors, intoxicated persons or Indians.

The enforcement of the criminal provisions of the Act is not the direct duty of the Board and although its employees have to a degree carried on enforcement work where violations have been so flagrant as to necessitate some action, the Board believes that its only enforcement agency should be its licensing power which when wisely and discreetly used becomes a most effective means of control. To sum up, the Board has held before it con-

stantly the promoting of temperance and moderation in the consumption of alcoholic beverages.

Unfounded Criticism

Certain elements have sought to disseminate misleading information concerning matters directly or indirectly related to control of the liquor traffic. They play on the fears and credulity of the public and are doing all they can to discourage and discredit the efforts of those charged under the law with liquor regulation. The Board believes that if their appeal to the universal desire for temperance were sincere, they would be willing to adopt methods better suited to encourage self-restraint and real temperance and they would be willing to permit the people to exercise their right to govern themselves.

Merchandising Operation

POLICY OF LIQUOR PURCHASES AND SALES

Price Lists

During the year it was found by the Board that a policy of one price list per year could not be continued. Changing qualities of materials brought about primarily by the aging of stocks and changing prices brought about by Reciprocal Trade Agreements with other countries and by changing basic market conditions in this country, make it impractical for the Board to confine itself to one price list per year. A complete new price list was issued on October 1, 1935, and the Board at that time hoped to continue its use for the entire period. However, on January 2, 1936, it was necessary to issue a price revision on those items affected by the Reciprocal Trade Agreements between our government and Great Britain and Canada. These prices continued until May 4, 1936, when an entirely new price list was issued which contained sweeping changes.

Beginning with the October 1, 1935, price list and continuing in all subsequent lists, the prices quoted contain the 10% sales tax. This sales tax became effective May 1, 1935, and from that date to September 30, 1935, the tax was assessed on the price appearing in the list and collected in addition thereto on each purchase. Experience with the collection of the tax in the liquor stores indicated the desirability of incorporating the 10% tax in the price appearing in the list. Under the law the tax cannot be absorbed but must be paid by the purchaser in addition to the regular retail price. Therefore, in publishing the price lists, the Board has computed the retail selling price and added the 10% sales tax thereto. For the convenience of the purchaser and the simplification of store operation, prices were set on a basis of multiples of five thus eliminating the use of pennies.

During the last months of the period, the Board made an intensive study of past sales and of available new items, preparatory to issuing a new price list on October 1, 1936. A careful study of the wine business, which represents about 37% of the Board's sales, caused the Board to feel that domestic (United States) wine listings should be extended to offer the people of the state a broader choice of sweet wines. Accordingly, several new brands of California wine and one new eastern brand were added. The spirituous brackets were also broadened somewhat to give the people of the state an opportunity to choose from a greater number of brands found to be popular in other states. These listings are now as broad as is feasible and a careful study will be made with the idea of reducing the number of brands in the next price list.

Reduction in Prices

In the spirituous brackets, there have been substantial reductions in the prices of the better quality merchandise. This reduction has been brought about partially by the pressure of tariff reductions and partially by the increased quantity of available well-aged merchandise. In the young and less expensive lines of merchandise, there has been no reduction and a reduction cannot be expected. However, the increased age of these less expensive items at no increase in price is really equivalent to a reduction in price as

far as the consumer is concerned. The price list effective October 1, 1936, contains no whiskies younger than twelve months. The Board feels that as whiskies grow older the age requirements of the Federal Government for "Straight Whiskey" label should also be required by the State of Washington.

Washington State Products

In order to cooperate with Washington State distilleries and rectifiers, and to encourage home industry, the Board has listed all of the merchandise offered which has a fair chance of success. In March, 1936, new bids were invited covering the Board's requirements for Red Label and Black Label gins, which are bottled by the distilleries under the Board's own labels. A Seattle distillery was successful in obtaining the Red Label gin. The price lists have reflected the savings effected by these new gin costs.

Special Orders

In order to care for the needs of commercial alcohol purchasers, a separate Distributing Unit was set up under the jurisdiction of the purchasing department in 1934 soon after the store system was functioning. Since that time the scope of operation of Distributing Unit No. 1 has been gradually extended to cover all merchandising transactions which do not properly come under store and agency operation.

Admittedly, it is impractical for the Board to carry on its price list all of the quality wines and liquors available. Many citizens would like to obtain certain items to which they are partial. In order to accomplish this, machinery was set up in Distributing Unit No. 1 whereby special orders are handled on the same average markup as material handled by the stores and agencies.

STORE OPERATIONS

Store Leases

During the fiscal period, the Board found that the 48 stores in operation at the beginning of the period were adequately serving the needs of the people and consequently no new stores were opened. The dollar sales volume has shown a considerable increase and the unit or gallonage volume has increased even more rapidly. This has been brought about by improved business conditions and by a greater demand for low price items, particularly wine. As a result, the Board has found it necessary to enlarge the storage room and sales room in several of the stores. The Hoquiam store and the store at 7 Mercer Street in Seattle were moved to entirely new locations in order to get suitable facilities. In several other instances it was possible to negotiate for additional adjoining space thus gaining the added facilities without going to the expense and inconvenience of moving the store to an entirely new location. It appears to the Board that it will be necessary to increase the space in many of the other stores in the near future and plans are being made accordingly.

During the year, 23 new store leases were completed. In spite of the fact that the floor space was increased in several of the stores, the total monthly rental for the 48 stores for September, 1936, was \$4,147.00 as against \$4,329.50 for September, 1935, or a reduction of \$182.50 per month. The Board feels that this is a favorable showing when the rise in real estate values and improvement in general rental conditions is considered.

responsibility that it is necessary to place upon a club operating under a pool system. However, the pool system has provided a method whereby the Board can regulate the clubs, whereas under the former locker system many of the clubs were openly violating the law through the sale of liquor by the drink. Within the past year the Board has sought, through its inspector, to educate the clubs in the proper method of operation, and has not had occasion to revoke any club's license. It is believed that ample opportunity has been given the clubs to become familiar with the regulations governing their operations and it is contemplated that violations in the future will be met with severe penalties.

BREWERS AND BEER WHOLESALERS

On September 30, 1936, licenses were held by 267 beer wholesalers and 17 brewers, representing an employment of approximately 17,012 persons, with an estimated annual payroll of \$3,200,000.00. The brewery capital investment only is \$7,024,162.00, exclusive of two plants that are not as yet in operation.

Establishment of a Separate Division

On January 8, 1936, there was established a Brewers' and Beer Wholesalers' Division to handle all matters pertaining to the operation of brewers and beer wholesalers other than the collection of tax. Working under the supervisor of this division at the present time are eight persons, including two field investigators and one auditor. Since the establishment of this separate division there has been a very noticeable improvement in general operations of brewers and beer wholesalers throughout the State.

Regulation of Excessive Credits

One of the most difficult problems encountered during the fiscal year was the solution of the credit problem as between beer wholesalers and retailers. It became apparent to the Board that many retail licensees were very effectively "controlled," contrary to section 90 of the Act, by the extension of excessive credits. In some few cases balances owing creditor brewers and beer wholesalers were far in excess of the actual value of the retail premises. To remedy this situation, the Board adopted a regulation which became effective November 1, 1935, requiring all on-premise license holders to pay cash for their beer at the time of delivery, and provision was also made in the same regulation for the liquidation of unpaid balances at the minimum rate of 50c per barrel and 25c per case on beer thereafter purchased without regard to the source from which the beer was purchased. In the promulgation of this regulation, the Board was only interested in eliminating the "control" of retail accounts as prohibited by section 90 of the Washington State Liquor Act. Under the present plan of operation, 1937 licenses will not be issued to creditor brewers and beer wholesalers, and debtor retail accounts will operate only on temporary permits until all "control" items through credit extensions are entirely eliminated.

Tap Markers

On March 15, 1936, retail dispensers were requested by Board regulation to display on all taps or other dispensing apparatus a sign or tap marker designating the brand of beer being dispensed from each tap. The adoption

of this regulation by the Board corrected an abuse which was becoming prevalent in some retail establishments of selling several brands of beer from one tap. Under this regulation brewers and beer wholesalers are permitted to furnish these tap markers to retail licensees provided the tap marker does not exceed a cost or value of 40c each.

Penalties

Under the provisions of the Washington State Liquor Act, the only penalties which the Board may impose on violations of the Act or regulations by brewers or beer wholesalers is suspension or cancellation of their respective licenses. It has been demonstrated during the past year that many of the violations are of minor nature, not warranting such drastic punishment as suspension or cancellation of licenses. Rather than allow numerous minor infractions to go unpunished a very effective method of handling this situation was found in suspending sales for a stated period by brewers or beer wholesalers to certain retail accounts where violations occurred. During the past year, 33 such orders have been issued on hearings involving brewers and beer wholesalers, 23 of the orders being of a minor nature, dealing with more or less minor violations such as sales to unlicensed premises, "treating" in retail premises by brewery representatives, and the furnishing of various novelties, advertising, etc., to retail places, contrary to regulations.

Production

From October 1, 1935, to September 30, 1936, inclusive, Washington brewers produced approximately 849,000 barrels of beer. Of this production some 564,000 barrels were sold in the State of Washington and some 285,000 barrels were exported, the export shipments amounting to 33% of the total Washington beer production. During the same period approximately 114,000 barrels of beer were sold in the State of Washington by out-of-state brewers. In other words, $2\frac{1}{2}$ barrels of Washington beer were exported by Washington brewers for every barrel of out-of-state beer that was imported for consumption in the State and the Washington brewers supplied 5 barrels out of every 6 consumed in the State of Washington, or approximately 83% of the total beer consumption of Washington.

Effect of Statutory Changes

An amendment was made to the Washington State Liquor Act by the 1935 Legislature requiring a license of all out-of-state brewers whose products were sold by licensees in the State of Washington. During the past year this particular amendment was declared unconstitutional by a three-judge Federal Court in Tacoma, the court holding in substance that where title is taken to beer in Milwaukee by local wholesalers the State of Washington is without authority to exact license fees of out-of-state brewers.

Contacts Through Circulars and With Associations

The Board contacts brewers and beer wholesalers by communications of various forms. Bulletins are issued from time to time to industry members, construing various regulations and correcting abuses which crop up in the industry. During the past year sixteen bulletins, consecutively numbered, were issued to industry members, including a bulletin on the cash

regulation, a bulletin on the tap marking regulation and a bulletin defining pasteurized beer.

Splendid cooperation has been received by the Board from the Washington Brewers Institute (the state brewers' association) and from the Pacific Northwest Beverage Distributors, Inc. (the state wholesalers' association) in checking unfair practices and in correcting abuses which are prevalent in the industry from time to time.

DISTILLERS AND RECTIFIERS

On September 30, 1936, licenses were held by one commercial distiller, two fruit distillers and one rectifier. Products from all of these concerns are being stocked on the shelves of the state stores and agencies. The two fruit distillers are making brandies and liquors produced exclusively and entirely from fruit products grown in the State of Washington, whereas the commercial distillery and rectifying plant are using out-of-state products to a great extent.

DOMESTIC WINERIES

Effect of Statutory Changes

In order that the small winery, whose production was too small to be economically sold through the state store and agency system, might have an opportunity to market its product, the 1935 session of the Legislature provided that "domestic" wineries (wineries whose products are made exclusively and entirely from Washington fruits and fruit products) could sell wine directly to retail licensees. A tax of ten cents per gallon was imposed and has been collected by the Board by means of stamps. The Board's experience under this procedure indicates that the wine industry has developed rapidly in the State and that the operators are well satisfied.

Number of Domestic Wineries

Twenty-eight licenses were issued to domestic wineries in the State of Washington during the twelve-month period ending September 30, 1936; of this number 7 were marketing their products through 41 licensed beer wholesalers throughout the State and 9 were handling their distribution directly from their own wineries to retail licensees. The remaining 12 wineries were comparatively new plants and were still aging their stock. Two of the plants holding domestic winery licenses also held licenses as fruit distilleries.

Remarkable Increase in Volume

Domestic wine sales showed a remarkable increase, and practically all plants are increasing their present wine storage about 50 per cent. In July, 1935, 4,470 gallons of domestic wines were sold to Washington consumers, while in July, 1936, the domestic wine sales amounted to 28,218 gallons. From October 1, 1935, to September 30, 1936, stamp purchases by domestic wineries indicated that a total of 263,135 gallons of domestic wines were sold to Washington consumers. During the month of September, 1936, the sales of domestic wines represented over 25 per cent of the total wines sold in the State.

Supervision

With the increase in wine sales and production came an increase in details of supervision. Working under the supervisor of the Division of Brewers and Beer Wholesalers at the end of the fiscal period were two inspectors, one a graduate chemist who handled all the laboratory work in connection with beer, wine and liquor analyses, and the other a field man, assigned to winery inspections, whose duties were to check operations and monthly material reports of wineries. Splendid cooperation was received from the State Department of Agriculture in checking the sanitation of the various winery plants, and under a policy adopted by the Board, no license will be issued after September 30, 1936, without written approval from the Department of Agriculture to the effect that the premises are clean and wholesome and the product of passable quality.

ADVERTISING

Supervision

In the supervision of liquor advertising during the past fiscal year, the Board has endeavored to carry out a policy of encouraging conservative and dignified advertising by requesting the advertisers and the various advertising media to adopt self-imposed restriction. The results thus far attained have, we believe, justified the policy.

As the program adopted by the advertisers and the various media acquired definite form, the Board assumed responsibility for the enforcement of that program. Thus, definite progress has been made. At this time, the depicting of women or children or any advertising appealing to women or children has been eliminated from newspaper and radio advertising. Men, women or children are not permitted in any form of outdoor advertising. Various forms of novelty advertising are prohibited. Prize contests or the awarding of premiums are also prohibited. Many other restrictions have been imposed.

Approval of Advertising Copy

Although the Board has not as yet required that advertising copy be submitted prior to publication, it is only fair to state that numerous advertising agencies regularly submit all proof to the Board for criticism. Such matters have received immediate attention; if no objection to the proof is made, the company submitting the same is so notified. Likewise, if corrections are required or the proof is disapproved in its entirety, the submitting company is so notified. The fullest cooperation has been received in this connection.

Hearings and Conferences

During the past fiscal year, the Board found it necessary to hold a hearing in only one instance. The various advertising media have, from time to time, been advised as to any changes in policy or as to any recommendations in connection with this subject. Numerous conferences have been held with newspaper and radio representatives, outdoor advertising companies and various advertising agencies relative to the liquor advertising problem, and have brought fair results which we believe are reflected in the present status of advertising in the state.